FINAL REPORT
Public Retirement Systems Committee

February 26, 2018

MEMBERS

Senator Charles Schneider, Vice Chairperson
Senator Michael Breitbach
Senator Jeff Danielson
Senator Mark S. Lofgren
Senator Matt McCoy

Representative Dawn E. Pettengill, Chairperson
Representative Jane Bloomingdale
Representative Wes Breckenridge
Representative Gary Carlson
Representative Mary Mascher

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I. Committee Proceedings

The committee met on December 18, 2017, during the 2017 Legislative Interim.

II. Judicial Retirement System

Mr. Todd Nuccio, State Court Administrator, and Ms. Patrice Beckham, Consulting Actuary, Cavanaugh Macdonald Consulting, LLC, provided background on the retirement system which covers all full-time judges and other judicial officers. Mr. Nuccio noted that the Judicial Retirement System is referenced in the Iowa State Constitution and is administered by the State Court Administrator. The Treasurer of State is responsible for investing the assets of the retirement fund. Ms. Beckham provided the committee a primer on actuarial concepts and then discussed the July 1, 2017, actuarial valuation of the system. The funded status of the system based upon the actuarial value of assets has made considerable improvement, improving to 91 percent on July 1, 2017, from 87 percent in the prior fiscal year. As a result, the fixed statutory contribution rate exceeds the actuarially required rate which should assist in further improving the funded status of the system. Ms. Beckham noted that an experience study relative to the assumptions used in conducting an actuarial valuation will be conducted in 2018 and will be used for the July 1, 2018, valuation. Assuming all current assumptions are met, the system should be fully funded by July 1, 2021, dependent largely on future investment returns and maintenance of the existing statutory contribution rates. Committee members asked questions about the asset allocation of the existing portfolio as well as about current investment return and mortality assumptions.

III. Iowa Public Employees' Retirement System (IPERS)

IPERS Staff. Ms. Donna Mueller, Chief Executive Officer, and Ms. Beckham provided an overview of the retirement system, focusing primarily on the June 30, 2017, actuarial valuation of the system. Ms. Mueller noted that the historical goals for IPERS are to attract and retain a quality workforce and to provide a secure retirement with lifetime pension payments. Ms. Mueller noted that IPERS' funding shortfall of $5.6 billion prior to 2017 was largely due to over a decade of insufficient contributions, two recessions, updated mortality tables, and unfunded benefit enhancements. Ms. Beckham then discussed the July 1, 2017, actuarial valuation of the system. Since the 2016 valuation, an experience study relative to the economic assumptions applicable to the system was conducted and several economic assumptions were changed for purposes of the 2017 valuation, most notably a reduction in the assumed investment rate return from 7.5 percent to 7 percent. As a result, the unfunded actuarial liability for the entire system increased from $5.6 billion in the 2016 valuation to $6.9 billion for the 2017 valuation. This increased liability resulted in the funded status of the system based on the actuarial value of assets decreasing to 81.4 percent with the funded ratio for the regular IPERS membership at 80.4 percent. The funded ratios for the two public safety subgroups of IPERS are 93 percent for the sheriffs and deputies classification and 97.8 percent for the protection occupation classification. The total contribution rate for the regular membership classification will increase to 15.73 percent of pay, payable on a 60-40 employer and employee basis, beginning July 1, 2018. For members of the sheriffs and deputies classification, the total contribution rate will increase from 18.76 percent of pay to 19.52 percent, payable on a 50-50 employer and employee basis. For members of the protection occupation classification, the total contribution rate will increase to 17.02 percent of pay, payable on a 60-40 employer and employee basis. Ms. Beckham noted that if all assumptions are met, the protection occupation classification would reach full funding in about 20 years while both the regular membership and sheriffs and deputies classification will reach full funding in around 27 years.

IPERS Investment Board. Mr. Karl Koch, Chief Investment Officer, addressed the committee relative to the role of the investment board and IPERS investments. Mr. Koch noted the fiduciary responsibility of the board as a trustee of the IPERS fund and its role in setting and reviewing investment policy and actuarial assumptions. He also noted that IPERS remains a well-diversified portfolio with an increasing effort in managing risk. Mr. Koch discussed the asset allocation of the IPERS portfolio, noting that the determination of this allocation is critical in determining the rate of return. He noted that the rate of return for fiscal year 2017 was 11.7 percent. In response to committee questions, Mr. Koch stated that the investment consultants utilized by IPERS estimate that the rate of return on the IPERS portfolio for the next 10 years will be about 6.25 percent with an estimated 30-year return of 7.3 percent. Mr. Koch then noted that the investment board has approved exploring the possibility of using internal investment managers for some of IPERS' portfolio. Currently, IPERS relies entirely on external managers to invest the IPERS portfolio. Mr. Koch stated that South Dakota has gone to internal managers for some of their portfolio and commented that internal management could save millions of dollars by reducing investment management expenses while providing better oversight. He did note the significant start-up costs that would be incurred if a move to internal investment management is made, including increased compensation for internal investment managers. More discussion is needed and Mr. Koch stated that any change in approach would need legislative action, to include increasing the authority of the IPERS investment board.

IPERS Benefit Advisory Committee (BAC). Mr. Len Cockman, Chair, addressed the committee. The goal of membership groups represented on the BAC is the long-term viability of the IPERS trust fund. In 2010, members responded to financial challenges facing the system by supporting legislation reducing benefits for all members and increasing contribution rates. Mr. Cockman noted that BAC supported initiatives in maintaining the soundness of the system have included support of anti-wage spiking legislation, excluding bonuses and allowances in calculating IPERS benefits, and supporting the use of actuarial cost studies in examining possible changes to IPERS. Ms. Mueller further noted that Iowa is one of only three states with public defined contribution plans in which the contribution rate for employees is not fixed but is a stated percentage of the actuarial required contribution rate.

IV. Peace Officers' Retirement System (PORS)

Ms. Roxann Ryan, Commissioner of the Iowa Department of Public Safety, and Ms. Beckham provided background on the system. Ms. Ryan noted that the system is governed by a board of trustees, covers sworn peace officers of the Iowa Department of Public Safety, and members of the system are not covered by Social Security. Ms. Beckham then discussed the July 1, 2017, actuarial valuation of the system. Since the 2016 valuation which included changes to the economic assumptions for the system, an experience study relative to the demographic assumptions applicable to the system was completed and several demographic assumptions were changed for purposes of the 2017 valuation, most notably using the newest mortality table published by the Society of Actuaries. As a result of these assumption changes, the unfunded actuarial liability for the entire system increased from $152 million to $182.9 million. This increase resulted in the funded status of the system based on the actuarial value of assets decreasing to 71 percent. In addition, Ms. Beckham noted that the downward trend of active members of the system compared to retirees is a concern in that reduced payroll growth impacts the ability to pay off the unfunded liability of the system. However, 2010 legislative changes increasing contribution rates for employers and employees, changing the calculation of postretirement adjustments to benefits, and providing for a supplemental state contribution have improved the funding status of the system. Long-term, the financial health of the system is dependent on future investment returns and scheduled contributions, including continued payment of the state supplemental payments of $5 million until the system is 85 percent funded. If all assumptions are met, the system will achieve fully funded status in 2039. In response to committee questions, the presenters noted that overtime is not included in calculating a benefit under the system.

V. Department of Administrative Services (DAS) — Retirement Investors' Club

Ms. Janet Phipps, Director, DAS, discussed the supplemental deferred compensation programs operated by DAS collectively called the Retirement Investors' Club (RIC). The programs are differentiated by the three applicable Internal Revenue Code sections describing public employee deferred compensation programs, sections 457, 401a, and 403b. The 457 program is available to primarily state employees, includes an employer match component (401a), and is utilized by about 55 percent of eligible state employees. The state's 403b program, which covers primarily educational employees, was established in 2009, is available to educational employers and their employees who participate in the program, and is utilized by about 13,000 participants. All programs offer core providers of investment products which were selected pursuant to certain requirements relating to fees and other service and performance metrics. In addition, the 403b program offers optional providers and is made available for school districts at an annual management cost to DAS of $400. Pursuant to legislation enacted during the 2017 Legislative Session, DAS is utilizing an invitation to qualify (ITQ) process to allow vendors eligible under the new legislation to become additional optional providers. An initial ITQ for these vendors was unsuccessful but a new ITQ is being issued. Committee members expressed the hope that participation rates would increase and some committee members commented that the intent of the new legislation was to increase the number of optional providers and to make all optional providers available to all 403b participants in the state program.

VI. Municipal Fire and Police Retirement System of Iowa (MFPRSI)

Mr. Terry Slattery, Executive Director, MFPRSI, and Mr. Glen Gahan, Actuary, Silverstone Group, provided background information concerning the retirement system. Mr. Slattery noted that the mission of the system is to provide a comprehensive set of retirement and disability benefits to eligible local police officers and fire fighters in a sound, sustainable, and efficient manner, in accordance with the requirements of the program's governing statute. The vision statement for the system provides additional background on the mission goals of providing a comprehensive, efficient, sound, and sustainable retirement system. Mr. Slattery reviewed the current investment allocation policy and noted that the plan performance since the inception of the statewide system in 1992 is 7.7 percent. Mr. Slattery then discussed the responsibilities and major activities of the system and continuing challenges for the system. Mr. Slattery noted that the board of trustees report on the system supports having the state resume its contribution to the retirement system at 3.79 percent of earnable compensation in order to reinstate the funding agreement between the state and the participating cities from 1976. Mr. Gahan then discussed the July 1, 2017, actuarial valuation of the system. Mr. Gahan noted that the system changed its future mortality improvement assumption for purposes of the 2017 valuation. As a result of this change, coupled with strong investment performance for the last fiscal year, the funded ratio of the system based on the actuarial value of assets is 81.4 percent as of July 1, 2017, and the city contribution rate beginning July 1, 2018, will increase to 26.02 percent. Mr. Gahan discussed future trends in the actuarial contribution rate to be paid by cities and the system's funded ratio over the next 25 years using current assumptions. By the end of the 25-year period, the system would be over 99 percent funded and the city contribution rate would decrease to the required minimum city contribution rate of 17 percent.

VII. Materials Filed With the Legislative Services Agency

The materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the "Committee Documents" link on the committee's Internet site: www.legis.iowa.gov/committees/meetings/documents?committee=655&ga=ALL

1. PORS — State Police Officers Council comments
2. MFPRSI — Iowa Professional Fire Fighters and Iowa State Police Association comments
3. IPERS — State Police Officers Council comments
4. 2017 — Public Retirement Systems Committee — written comments
5. PORS — System Presentation
6. MFPRSI — System Report
7. JudRet — System Presentation
8. IPERS — System Presentation
9. DAS — Retirement Investors' Club Presentation